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**Before the**
**FEDERAL COMMUNICATIONS COMMISSION**
**Washington, D.C.**

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| In the Matter of | ) | |
| 1998 Biennial Regulatory Review -- Review of Depreciation Requirements for Incumbent Local Exchange Carriers. | ) | CC Docket No. 98-137 |



# COMMENTS OF BELL ATLANTIC

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**COMMENTS OF BELL ATLANTIC**[1]

Under the Commission's price cap scheme of regulation, there can be no serious dispute that depreciation accounting has absolutely no impact on day to day rate levels. As a result, continued federal regulation of depreciation rates for price cap carriers is an anachronistic holdover from a bygone regulatory regime and should be eliminated.

The Notice, however, proposes only modest changes in depreciation regulation. It declines to propose any meaningful reform, pointing to certain limited instances in which depreciation may still be relevant. But each of those specific cases can be easily addressed without retaining the Commission's rules regulating depreciation rates. As a result, those rules no longer are necessary to serve a legitimate public policy purpose and should be eliminated.

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[1] The Bell Atlantic telephone companies ("Bell Atlantic") are Bell Atlantic-Delaware, Inc.; Bell Atlantic-Maryland, Inc.; Bell Atlantic-New Jersey, Inc.; Bell Atlantic-Pennsylvania, Inc.; Bell Atlantic-Virginia, Inc.; Bell Atlantic-Washington, D.C., Inc.; Bell Atlantic-West Virginia, Inc.; New York Telephone Company; and New England Telephone and Telegraph Company.

## 1. The Act requires the Commission to eliminate regulations that are no longer necessary.

Under the 1996 Act, the Commission is required to eliminate regulations that are not necessary to serve the public interest, either as part of a biennial review of its regulations or in response to a petition for forbearance.

First, under section 11, the Commission is required to conduct biennial reviews of its regulations and to eliminate any that are "no longer necessary in the public interest." 47 U.S.C. § 161(b). As the Commission itself has recognized, a regulation is not "necessary" if the underlying policy concern can be addressed in another manner with less regulation. *See Policy and Rules Concerning the Interstate, Interexchange Marketplace*, 11 FCC Rcd 20730, 20742-47 (1996) (competition and the availability of complaint proceedings make mandatory tariffs unnecessary for interexchange carriers). And individual regulations do not even serve the public interest – let alone satisfy the requirement that they be "necessary" to serve the public interest – unless "their benefits significantly outweigh their costs." *Computer III Further Remand Proceedings*, 13 FCC Rcd 6040, 6121, Separate Statement of Commissioner Furtchtgott-Roth (1998).

Second, in response to a forbearance petition under section 10(a) of the Act (such as the pending USTA petition to eliminate depreciation regulation), the Commission "shall" forbear if its regulations are no longer "necessary" to ensure that rates are reasonable or to protect consumers (subsections 1 and 2) and forbearance is in the public interest (subsection 3). 47 U.S.C. 160(a). The Commission also is required to consider whether forbearance will promote competition, *see* § 160(b) – for example, by removing a regulatory burden that applies only to one group of competitors and not another.

Under either standard, the Commission is obliged to forbear from continued regulation of depreciation accounting.

**2. Continued Commission regulation of depreciation is not necessary.**

Price cap regulation breaks the link between local exchange carrier prices and regulated accounting costs (including deprecation expense). As a result, depreciation rates are irrelevant for purposes of setting prices, and regulation of depreciation no longer is necessary for its original regulatory purpose. *See Prescription of Revised Depreciation Rates for Cincinnati, US West and SBC*, Statement of Commissioner Furchtgott-Roth, 13 FCC Rcd 6221, 6233 (1998) (the "Commission's authority to prescribe depreciation rates is merely a vestige of outdated rate-of-return regulation" and "in a system of pure price cap regulation, the depreciation rate requirements . . . would be unnecessary and should be eliminated for the larger carriers").

In adopting a limited simplification of its rules four years ago, the Commission nevertheless declined to forbear because the price cap rules at that time included an earnings-based sharing component. As a result, the Commission concluded that depreciation decisions could have had an impact on a carrier's sharing obligations such that "ratepayers would lose future rate reductions that would normally accompany a carrier's sharing obligation." *Simplification of the Depreciation Prescription Process*, 8 FCC Rcd 8025, 8043 (1993). Now that the Commission has eliminated earnings sharing, that link is gone and there is no longer any basis for continued Commission regulation.

Not only is depreciation unnecessary under current regulation, its elimination would produce significant public interest benefits. Indeed, the Commission has for years recognized the public interest benefit in working toward elimination of its own

depreciation regulation. It was the Commission that sought and received from Congress a change in the language of section 220 (b), which expressly made Commission regulation of depreciation permissive, rather than mandatory. *See* Statement of Reed Hundt on FY 1997 Budget Estimates Before the House SubCommittee on Commerce, Justice, State, the Judiciary and Related Agencies, Committee on Appropriations (May 7, 1996) (the repeal of mandatory setting of depreciation rates for common carriers was one of "21 provisions proposed by the FCC to eliminate certain regulatory functions" and "to reduce regulatory burdens on industry").

When the Commission last examined deprecation regulation, it recognized the significant burden that continued regulation of depreciation imposes. While the streamlining adopted in 1993 has reduced the estimated $35-50 million annual price tag for depreciation regulation, the cost remains substantial. *See Simplification of Depreciation* at 8032. In order to change depreciation rates, price cap carriers still must file federal represcriptions; and, in addition to the economically based depreciation they maintain for financial reporting purposes, carriers must track separate depreciation reserves for state and federal regulators based on their own specific regulatory requirements. The costs and burdens imposed by the requirement to maintain a redundant and unnecessary depreciation scheme should be eliminated.

Nothing in the minor changes proposed by the Commission would eliminate these burdens.[2] Moreover, elimination of these burdens, which impact incumbent local

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[2] While the Act requires that the Commission eliminate depreciation regulation altogether, if the Commission were nonetheless to continue such regulation, all life and salvage ranges need to be reviewed to be more consistent with today's market and technology. In addition, if the Commission retains its regulations, it should not

exchange carriers but not new entrants, will contribute to more equitable and efficient competition. If the Commission continues depreciation regulation, it continues to superimpose its judgment on a small group of competitors using a method that requires consistency not with their individual strategic technology and marketing plans, but with dated fixed regulatory prescribed ranges. Such a "one size fits all" approach imposed on a segment of the market can only serve to inhibit the development of competition. *See* Section 10 (b) [47 U.S.C. § 160(b)].

### 3. The limited instances where depreciation may be relevant do not justify retaining the Commission's regulations

Commission forbearance of depreciation will not leave carriers free to set depreciation levels at their whim. Like all publicly held corporations, Bell Atlantic and other carriers will be subject to the requirements of GAAP (generally accepted accounting principles) and the oversight of independent auditors.[3] Such constraints require a conservative and consistent reporting of depreciation in order to obtain capital in the market and avoid SEC sanctions or litigation damages. As a result, the

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adjust the treatment of salvage. The FASB has not made a final ruling on the depreciation treatment of salvage and Commission action now runs the risk of creating yet another inconsistency with financial accounting rules (GAAP). Removing salvage from depreciation calculations and including it as an expense would require that Bell Atlantic modify its systems at a cost of more than half a million dollars – far in excess of any benefit associated with such a "simplification."

[3] If the Commission were to eliminate its regulations for price cap carriers, Bell Atlantic would adopt the same life parameters that it uses for depreciating its investment on its financial books. Over time the difference between the financial books and the regulatory books would be eliminated either through an amortization or the self-correcting mechanics of the remaining life valuation method. In order to facilitate the conversion from regulated life parameters to economically based depreciation, the Commission should act quickly and allow carriers to adjust their depreciation schedules retroactive to January 1, 1999.

Commission will have a useful real world measure of what carriers' depreciation rates should be. While the Commission rejected the sufficiency of these controls in 1993, it was clear that it was only "unpersuasive at [that] time" because the conservatism required in GAAP would not protect from a depreciation rate that impacted sharing – a concern that no longer has any relevance. *Simplification of Depreciation* at 8043.

Nevertheless, the Notice proposes to retain the bulk of the Commission's depreciation regulation. It justifies this proposal by pointing to a few limited instances in which depreciation may still be relevant. Notice, ¶ 6. But any real concerns about the limited instances cited by the Commission can be addressed without retaining the FCC's depreciation rules.

a. Lower formula adjustment. As a condition of a lower formula adjustment, a carrier could be required to address the question of whether its depreciation practices are reasonable. *See* USTA Petition at 12. The Commission can accomplish this review by making a rebuttable presumption that the depreciation rates of the applying carrier that are used for financial reporting purposes are correct.[4] This avoids turning a lower formula adjustment application automatically into a depreciation represcription hearing,

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[4] Because this solution fully addresses any impact that forbearance of depreciation regulation may have on the lower formula adjustment, there is no reason to require the Hobsian choice of only obtaining depreciation forbearance by giving up altogether a carrier's right to a lower formula adjustment. *See* Notice, ¶ 8. To the extent that such a "choice" results in regulated rates that do not allow a carrier to "recover legitimate and prudent expenses incurred in operating the business for the benefit of ratepayers, plus a fair return on its investment," such rates would be unlawful. *Accounting for Judgments and Other Costs Associated with Litigation*, 12 FCC Rcd 5112, ¶34 (1997); see also *Tenoco Oil Co. v. Dept. of Consumer Affairs*, 876 F.2d 1013, 1020 (1st Cir. 1989) ("rates must provide not only for a company's costs, but also for a fair return on investment").

yet still allows a safeguard to prevent the unlikely scenario of a carrier manipulating its depreciation practices in order to qualify for a one-time rate adjustment.[5]

b. Above-cap tariff filing. Similarly, there are already requirements for a cost showing in support of an above cap filing. *See* 47 C.F.R. §§ 61.49(e), 61.46 (c) and 61.47 (d). The contribution of depreciation expense to above cap rates will be subject to this stringent review, and the Commission can impose belt and suspenders safeguards (without retaining depreciation regulation) by explicitly making the level of depreciation expense a rebuttable presumption that the depreciation that should be used (and that is reasonable) is from the carriers' financial reports.

c. Universal service support. A move toward GAAP-based economic depreciation would make comparisons among all service providers more uniform and would be consistent with the Commission view that forward-looking costs are the appropriate universal service measure. The Commission and the Joint Board have already determined that universal service support must be portable -- *i.e.* a competing carrier that wins a customer also would benefit from the universal service support associated with that line. Because competing local exchange carriers are already free of Commission depreciation regulation, they already use GAAP-based economic depreciation levels. To retain current depreciation policies would continue a mismatch, and use of them for universal service calculations actually make cost comparisons less reliable.

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[5] The Notice raises as a separate concern the possibility of a claim for higher rates based on a constitutional takings claim. Notice, ¶ 6. In the course of such proceedings the Commission could raise the issue of whether depreciation expense accurately reflects the actual costs of the complaining carrier.

d. Productivity factor calculation. The FCC model used to set the annual price cap adjustment – the so-called "X factor" -- does not vary with changes in depreciation levels. *See* Statement of Professor Frank M. Gollop, Attachment B to USTA Comments ("The structure and assumptions of the Commission's model necessarily infer that changes in allowed depreciation rates affect the measured [productivity] and input price differentials but in exactly offsetting amounts, leaving the resulting X-Factors unaffected"). Moreover, even if there were an impact, the Commission has already acknowledged that its method for determining future X factors can be refined to avoid any distortions. *See Price Cap Performance Review*, 12 FCC Rcd 16642, ¶ 65 (1997) (agreeing that if the Commission were to forbear from depreciation regulation, the Commission would "determine the effect of the revised depreciation rates on [productivity] and the X-Factor in our next performance review"). The mere threat that there *may* need to be a review to determine *whether or not* the absence of depreciation regulation impacts future determinations of the X-factor, cannot justify permanently retaining such regulation.

e. Base factor portion calculations. The Notice's reliance on the use of depreciation in base factor portion ("BFP") cost projections as justification for continued depreciation regulation creates a vicious circle where one outdated remnant of rate of return regulation creates the justification for retaining another. Instead, the Commission should eliminate them both. Bell Atlantic has already demonstrated that continued forecasting of BFP costs is not necessary under price cap regulation. *See 1998 Biennial Review -- Part 61 of the Commission Rules*, CC Docket No. 98-131, Comments of Bell Atlantic at 2-4 (filed Oct. 16, 1998). In its place, the Commission should just calculate

subscriber line charges based on the lower of: the appropriate cap on end-user charges and the per-line amount of allowable recovery in the Common Line basket. As a result, depreciation levels would become irrelevant to the calculation. Even if the Commission does not adopt this improvement, however, financial depreciation provides a consistent measure for BFP calculations, which are only used to allocate recovery among groups of customers, and not to set overall recovery.

f. Exogenous changes. The "justification" that the Commission needs supervised depreciation to determine the size of exogenous changes is also a red herring. Depreciation changes themselves are not considered exogenous to price cap regulation and so will not result in a change in allowable prices. *Policy and Rules Concerning Rates for Dominant Carriers*, 5 FCC Rcd 6786, 6809 (1990). For other rate adjustments which are treated exogenously, the Commission has calculated the impact on price caps based on revenues rather than embedded costs. *See, e.g.*, *Tariffs Implementing Access Charge Reform*, 13 FCC Rcd 14683, ¶¶83, 88 (1998) (requiring revenues rather than Part 69 costs to determine the amount of price cap shift in moving line port costs out of the Traffic Sensitive basket and into the Common Line basket).

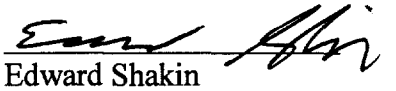
g. Rates set by state commissions. Determining interconnection and unbundled network element ("UNE") prices is a matter of state jurisdiction and there is no basis to assume that FCC mandated depreciation levels are necessary for states to set these rates. State regulators are using forward-looking cost studies, not rate of return depreciation expense recorded on their regulatory books to develop these prices. Moreover, even though depreciation lives are a component of those studies, many states have rejected the use of FCC regulation depreciation lives in favor of forward looking economic

depreciation lives. *See e.g., Application of MFS Intelenet*, Interim Order at 34, Pennsylvania PUC Docket No. A-310203F0002 (rel. Apr. 10, 1997) ("this Commission has endorsed forward-looking economic lives for ratemaking purposes, as opposed to the regulatory projection lives used for accounting purposes. We cannot abandon that policy and endorse depreciation lives here that are based on projection lives as prescribed by the FCC.") Indeed, the Commission has itself endorsed economic rather than regulatory depreciation for such purposes. *See* 47 C.F.R. § 51.505 (b) (3) (overturned on jurisdictional grounds in *Iowa Util. Bd. v. FCC*, 120 F.3d 753 (8th Cir. 1997*) cert. granted*, 118 S.Ct. 879 (1998)) ("The depreciation rates used in calculating forward-looking economic costs of elements shall be economic depreciation rates"). To the extent a state still prefers to rely on regulatory set depreciation rates, it retains the ability to set those rates on an intrastate basis. Under any circumstance, however, there is no necessity for continuation of federally mandated regulatory depreciation rates.

## Conclusion

The Commission should forbear from further regulation of depreciation rates.

Respectfully submitted,



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November 23, 1998

CERTIFICATE OF SERVICE

I hereby certify that on this 23rd day of November, 1998, a copy of the foregoing Comments of Bell Atlantic was sent by first class mail, postage prepaid, to the parties on the attached list.

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